Supreme Court, U.S.
FILED
AUG 28 2003
OFFICE OF THE CLERK

No. 02-1016

IN THE

Supreme Court of the United States

LEE M. TILL and AMY M. TILL,

Petitioners,

v.

SCS CREDIT CORP.,

Respondent.

On a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF OF AARP, *AMICUS CURIAE*, SUPPORTING THE PETITIONERS

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INTEREST OF AMICUS CURIAE

In the last year alone, more than 1.6 million American families filed for bankruptcy. A growing number of those families—unable to avoid the financial devastation of lay-offs, illness or divorce—include men and women age 50 or older. They are now the fastest-growing group in bankruptcy. AARP is a nonpartisan, nonprofit organization dedicated to representing the interests of older Americans. As *amicus*, it periodically has provided the Supreme Court with the perspective of its 35 million members.[1]

The significance of this case, particularly for older Americans, lies just below its surface. Like the U.S. Courts of Appeal, the principal parties disagree over the appropriate rate of interest for individual secured creditors under 11 U.S.C. § 1325(a)(5)(B)(ii). This is not simply a creditor-debtor dispute, however, about the interpretation of an arcane provision of consumer bankruptcy law. Rather, the case tests the very integrity of the Bankruptcy Code in Chapter 13, its balance and its effectiveness.

Lee and Amy Till are debtors. SCS Credit Corporation is a creditor, having lent the Tills the money to buy a truck that, in turn, collateralizes the loan. In deciding their case, this Court necessarily will ask whether Congress intended to provide a significant benefit to one creditor at the literal expense of every other creditor. It also will decide whether Chapter 13 provides an efficient and effective procedure for families to save their homes and cars, pay at least some of their debts, and rehabilitate themselves financially without resorting to liquidation in Chapter 7.

The growing economic vulnerability of older Americans is a national tragedy. The rate of bankruptcy filings, hitting

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[1] Each party's written consent for the submission of this brief is on file with the Clerk of the Court. Pursuant to Rule 37.6, AARP states that no counsel for any party authored this brief in whole or in part and that no party or entity other than AARP, its affiliates, or counsel made a monetary contribution to the preparation or submission of this brief.

new records each year, is rising faster among those 55 and older than the general population. Eighty percent of older families own their own homes and, faced with a financial crisis, they increasingly turn to Chapter 13 to save them.

Only in Chapter 13 can a family keep its home by paying any amount past due, curing that arrearage over time, and continuing regular payments at the mortgage rate of interest. The statute also requires, however, that the family pay all of its non-mortgage secured debt (based on the collateral's actual value) and commit all of its disposable income, after necessary living expenses, to unsecured creditors. The higher the rate of interest on that non-mortgage debt, the less a family has to sustain the mortgage and pay its other creditors pro-rata. Without those payments, a plan can neither be approved by the court nor, if approved, sustained.

For many older Americans, the financial margin is this thin, the choice is this stark: they can afford the mortgage and make reduced payments to all of their creditors, or they can pay a few creditors the full subprime interest rates on a car loan and collateralized consumer purchases. Since they cannot do both, the loss of their homes may well become inescapable.

The decision by the U.S. Court of Appeals for the Seventh Circuit means, quite simply, that fewer older Americans will be able to qualify for the bankruptcy law's protection with fewer still able to complete a plan of financial rehabilitation that leaves them with a home or a reserve for retirement or failing health. The Seventh Circuit's decision also means that a few secured creditors can demand subprime interest rates, even at predatory heights, through the three to five years of a Chapter 13 plan—not leaving enough either for mortgage payments or for other creditors.

Not only are older Americans most likely to want, to need, to save the homes they have, they are often on fixed or limited incomes with little prospect for significant increases.

Not surprisingly then, "[s]ubprime borrowers are more likely to be older than prime [rate] borrowers." U.S. Department of Housing and Urban Development, *HUD-Treasury Report 36*, at http://www.hud.gov/library/bookshelf18/pressrel/treasrpt.pdf (2001). For them, the rate of interest on secured (non-mortgage) debt in Chapter 13 may well determine their financial future. Amy and Lee Till are not yet 50. While the decision here will affect all debtors, AARP joins the Tills because its membership has more at risk in this case than any other age group.

In the Bankruptcy Code, Congress has guaranteed that creditors will receive the "value, as of the effective date of the plan," of their collateral whenever a Chapter 13 debtor elects to keep the family's car, mobile home, or appliance. Congress has not, however, promised some secured creditors more money than any other creditor *in* bankruptcy through the simple expedient of charging more interest *before* bankruptcy. The issue presented here is particularly important to AARP members not only because they often pay the highest interest rates but because the balanced protection Congress provides debtors and creditors in the federal bankruptcy law has heightened importance for older Americans.

SUMMARY OF ARGUMENT

In 1938, in the shadow of the Great Depression, Congress passed the Chandler Act to give American families facing financial disaster a choice. They could file a bankruptcy petition under Chapter 7, obtaining a discharge of some of their debt at the cost of liquidating all of their non-exempt assets and distributing the proceeds to creditors, or they could take advantage of a new procedure, Chapter 13. It enables families to save their homes by paying at least some of their debts under a three to five year plan, discharging the balance of their obligations upon the

completion of the plan. That statutory choice remains available today.

Congress has encouraged families to elect Chapter 13 by, systematically, providing incentives unavailable in Chapter 7. While more families still use Chapter 7, often because they have few if any unencumbered assets to protect, Chapter 13 helps families trying to keep their homes, including the mobile homes owned by so many older Americans, their cars and other consumer goods subject to a security interest. Chapter 13 permits a family to keep its car or mobile home by making payments based on the asset's fair market value, rather than the loan's balance at the time of the bankruptcy. Under this provision, known as a "cramdown," the difference between the collateral's fair market value and the outstanding loan becomes an unsecured debt.[2] The debtor pays a portion of that unsecured debt pro-rata, over time, with all of his or her other unsecured debt under a Chapter 13 plan.

Lee and Amy Till borrowed $6,425.00 in 1998 to buy a used truck. They agreed to pay 21 percent interest, a rate generally characterized as "subprime." By the time they filed for bankruptcy, the value of the truck had declined to $4,000.00, less than the loan balance. SCS Credit Corp., which held a perfected security interest in the truck, objected to the Tills' proposed Chapter 13 plan. To enable them to keep the truck, the three-year plan called for a 9.5 percent interest rate on the truck's value: a 1.5 percent risk premium added to the then-prime rate of eight percent. Objecting to the plan, SCS asked the court to apply the contract rate.

This case presents a single issue: What is the appropriate rate of interest under 11 U.S.C. § 1325(a)(5)(B)(ii) due the creditor on the debtors' payments for the *secured* "value" of

[2] This Court first noted the descriptive phrase in *St. Joe Paper Co. v. Atlantic Coast Line R. Co.*, 347 U.S. 298, 314-15 (1954), applying the Bankruptcy Act of 1935 to permit the approval of a reorganization plan despite the protests of "recalcitrant dissenters."

its loan? The Seventh Circuit in a 2-1 decision, disagreeing with the bankruptcy court, chose 21 percent, the contract rate, the highest rate. The court's majority was wrong.[3]

Congress has not authorized any court either to require that a debtor's plan presumptively use the contract rate of interest or to permit different secured creditors to collect the widely disparate amounts inevitable under either contract rate or market-based rate standards. Section 1325(a)(5) requires that the plan give the creditor "the value, as of the effective date of the plan, of property to be distributed under the plan ...." Nothing less, nothing more. In imposing the contract interest rate, the Court of Appeals exceeded its authority.

Since 1984, the bankruptcy law has required that all of a Chapter 13 debtor's disposable income be distributed to creditors. The decision by the Court of Appeals does not mean the debtor will have more or less available to spend—*all* of his or her disposable income must go to creditors in any case—but it does mean that a subprime creditor will receive relatively more than every other creditor.

In bankruptcy, both secured and unsecured creditors lose rights and money. To be sure, Congress establishes priorities in the Bankruptcy Code, determining the order in which debts are paid and whether in whole or in part. The law generally treats creditors similarly by classification: secured (non-mortgage) creditors receive the value of their collateral, and unsecured creditors are paid pro-rata from the remaining disposable income. A decision to permit some companies, most often those that finance car and mobile home loans, to be paid a larger share of their claims than any other creditor is not a decision Congress has made.

Had Congress intended to give each secured creditor a contract or market-based rate of interest for its Chapter 13

[3] While the Seventh Circuit characterized this "old contract rate" as the "presumptive rate," *In re Till*, Petitioners' Appendix, p. 20a, few debtors will be able to marshal the expert testimony and resources to rebut it.

claims, then it would have stated so specifically. Congress has done that often enough in other sections of the Bankruptcy Code, but *not* in section 1325.

The Code has been designed to treat legally similar creditors equally, to give debtors the opportunity for a fresh start, and to favor Chapter 13 over Chapter 7. The Seventh Circuit's decision collides with each of these fundamental principles. The majority's "coerced loan" theory presumptively adopts the contract rate of the loan, from a "bargain" struck perhaps years earlier, as the amount this creditor would charge were it to make a new loan. That overcompensates subprime creditors by awarding them full profit on their secured claims, even through bankruptcy, when every other creditor receives less (except, of course, where Congress has provided otherwise).

Three U.S. Courts of Appeal have declined to adopt the "coerced loan" theory that sustains subprime interest rates. *See GMAC v. Valenti (In re Valenti)*, 105 F.3d 55 (2d Cir. 1997); *Farm Credit Bank of Spokane v. Fowler (In re Fowler)*, 903 F.2d 694 (9th Cir. 1990); *United States v. Doud*, 869 F.2d 1144 (8th Cir. 1989). Instead, they have used a variable formula designed to give creditors the time value of the money to be repaid plus a premium for the risk perceived in the subprime loan. While this approach objectively recognizes the delayed value of a secured loan and eliminates differential treatment among secured creditors, it suffers from the same fatal flaw as the Seventh Circuit's decision: there is no Congressional authority for it.

Section 1325, by its own terms, compensates creditors for the value of the property at the time of the plan's confirmation. It does not compensate creditors for making a "new" loan, for overhead, for profits or for risks pre- or post-bankruptcy. The "value, as of the effective date of the plan"—that is, the total amount to be paid by the debtor in installments—necessarily is nothing more than interest over the life of the plan that protects the secured creditor against

inflation. The best measure of that interest is the rate paid by the U.S. Treasury on its obligations. Congress has authorized no other rate, and neither should this Court.

ARGUMENT

The practical consequences of this decision will be significant and widespread. Subprime lending has become pervasive: nearly 60 percent of American families hold loans that meet the term's definition.[4] *See* New Media Auto Services, Inc., *"Sub Prime" Lending*, *at* http://www.carinvoices.com/financing/about_financing/sub_prime_credit.htm (1999). On August 1, 2003, the published Treasury bill rate was 1.12 percent. That same day, the prime rate was 4.0 percent, the average was 6.14 percent for a 30-year, fixed-rate home mortgage and the average 60-month used car or truck loan was available at 5.6 percent interest.[5]

The difference in interest rate is often decisive. At today's average vehicle loan rate—not the 21 percent in the Tills' contract—the debtor would have available $1,900 more over five years given the stipulated value of the Tills' used truck. The time value of money standard (measured at the Treasury bill rate) would free up almost $2,400. For many families reorganizing in Chapter 13, the additional amount available to pay creditors might well be the difference between saving and losing their homes: it will, in

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[4] A subprime lender extends "credit to borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers." Federal Deposit Insurance Corporation, *Office of Inspector General, Audit Report No. 03-019*, p. 1 n.1, *at* http://www.fdic.gov/oig/a-rep03/03-019.pdf (March 18, 2003).

[5] *Weekly Mortgage Market Survey*, *at* http://www.freddiemac.com/learn/cgi-bin/dlink.cgi?jp+/PMMS/display/PMMSOutputyr.jsp&ENV=PROD (accessed Aug. 8, 2003); Moneycafe.com, *Rate, Definition & Historical Graph*, *at* http://www.nfsn.com/library/primehtm (Aug. 13, 2003).

many cases, enable their plans to be confirmed and completed.[6]

The Seventh Circuit erred in construing section 1325 as an entitlement, awarding each secured creditor its own pre-petition contract rate of interest. Nowhere in that provision or its legislative history does Congress state or even imply that creditors that have a car, mobile home, or any other collateralized consumer purchase as security are entitled to disparate contract rates of interest. The decision reflects a fundamental misunderstanding of the Bankruptcy Code.

I. SECTION 1325 DOES NOT PROVIDE FOR EITHER A CONTRACT OR A MARKET-BASED RATE OF INTEREST.

In Chapter 13, a secured creditor is entitled to the "value" of the property in which it asserts an interest up to the "allowed amount" of its claim. The allowed amount of a secured claim is the fair market replacement value of the security on the date of the debtor's plan confirmation.[7] Chapter 13 permits the debtor to keep the property by paying that "value" in installments—compensating the creditor for the time value of the money.

A. Congress Has Given The Bankruptcy Courts Sweeping Discretion To Modify Contract Terms.

Congress did not establish a fixed rate of interest to determine value over time. Instead, in 11 U.S.C. § 1322, it generally authorized the wholesale modification of the rights of all creditors, specifically permitting the courts to "modify the rights of holders of secured claims."

[6] Even where the plan could be completed at the subprime contract rate, the family's other creditors would lose their pro-rata share of the additional $2,400 that would go to the subprime truck lender alone.

[7] In *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953, 960 (1997), this Court held that the collateral itself should be valued in a Chapter 13 plan at its replacement cost.

> With respect to claims secured by any property other than a principal residence, this very significant power allows debtors to change contract terms by altering interest rates and monthly payments, by changing the length of the repayment period, by changing the total amount to be repaid and by modifying acceleration and default provisions.

2 Keith M. Lundin, CHAPTER 13 BANKRUPTCY § 104.1, at 104-1 (3d ed. 2002).

The courts have the discretion to modify the pre-petition interest rate so long as the creditor, at plan confirmation, receives the present value of the collateral. "Under Chapter 13 a debtor may *modify* the rights of any secured creditor *except* one whose claim is secured only by a mortgage on the debtor's principal residence." *Shearson Lehman Mortgage Corp. v. Laguna (In re Laguna)*, 944 F.2d 542, 544 (9th Cir. 1991), *overruled on other grounds, Rake v. Wade*, 508 U.S. 464 (1993). That single statutory exception, for home mortgage lenders, is explicit in section 1322(b)(2).

Section 1322 generally permits a debtor's plan to modify all contract rights. Section 1325 limits that authority by guaranteeing a secured creditor the value of the collateral at confirmation. There are no other limits. There is no other guarantee.

"In determining the scope of a statute, we look first to its language. If [it] is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'" *Russello v. United States*, 464 U.S. 16, 20 (1983). With or without ambiguity, moreover, the cramdown provision of section 1325 necessarily will be read in the context of the Bankruptcy Code as a whole. *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988)

("*Timbers*"). The plain language of the statute and the rules of statutory construction compel the same conclusion here: Congress did not intend a contract or market-based rate of interest to apply in cramdowns.

B. Congress Has Expressly Declined To Specify A Contract Rate Of Interest For Secured Creditors Under Section 1325.

Not only is it evident, from the face of the statute, that Congress did not grant secured creditors their contract rate of interest, Congress has declined to enact a contract rate provision. Prior to the Bankruptcy Amendments and Federal Judgeship Act, P.L. 98-353, 98 Stat. 333 (1984), Congress had proposals expressly requiring that the contract rate of interest be paid in a Chapter 13 cramdown. *See* H.R. 1085, 98th Cong. § 19(2)(A) (1983); H.R. 1169, 98th Cong. § 19(2)(A) (1983); H.R. 4786, 97th Cong. § 19(2)(A) (1981). Among other things, the legislation sought to amend section 1325(a)(5)(B)(ii) to ensure that "the value, as of the date of filing the plan, of property to be distributed under the plan is not less than the value determined under section 506(b) of this title *and, if such value is to be paid in installments, interest is to be paid at the rate specified in the consumer's contract.*" *Id.* (emphasis added). Congress never adopted the legislation.

In *Russello*, this Court concluded that "[w]here Congress includes limiting language in an earlier version of a bill but deletes it prior to enactment, it may be presumed that the limitation was not intended." 464 U.S. at 23-24. Congress specifically considered requiring a contract rate of interest in cramdowns but chose not to mandate it. The statute's focus is on "value," as of the plan's effective date, and that can only mean the time value of money.

C. Congress Expressly Provided For Contract And Market-Based Rates Of Interest In Other Sections Of The Bankruptcy Code.

In several sections of the Bankruptcy Code, Congress expressly provided for a specific rate of interest. In 11 U.S.C. § 1322, governing home mortgages, for example, it prohibited bankruptcy courts from modifying the pre-petition rate of interest established by contract. In 11 U.S.C. § 506(b), Congress allowed oversecured creditors to obtain contractual fees, costs and charges throughout the bankruptcy proceeding. Congress knew very well how to ensure that contract or market conditions remain in force in bankruptcy, and it has required just that in a series of Code provisions. Section 1325, however, is not among them.

Home Mortgages

Congress has specifically directed bankruptcy courts to apply the pre-petition contract rate of interest to home mortgages. While bankruptcy courts have broad discretion to "modify the rights" of all creditors, they may *not* modify "a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2). This provision unequivocally "proscribes modification of the rights of a homestead mortgagee." *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 327 (1993). A debtor can avoid home foreclosure only by continuing to pay the original contract rate of interest. *Id.* at 331-32. This explicit statutory exception, of course, has another effect: *all* of the other "rights of holders of secured claims" remain subject to modification.

Had Congress intended to provide a contract rate of interest for all security agreements, section 1322(b)(2)'s exception would be superfluous. "It is 'a cardinal principle of statutory construction' that 'a statute ought ... to be so construed that, ... no clause, sentence, or word shall be superfluous, void, or insignificant.'" *TRW, Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (citation omitted). If Congress had

wanted a contract rate of interest to apply in non-mortgage cramdowns, it would not have used the language it did in section 1322(b)(2).

Home mortgages are an exception, the only exception, to the rule permitting the modification of the contract rate of interest in cramdowns. Despite that, the Seventh Circuit's decision in effect has granted car lenders and mobile home lenders the same extraordinary protection for their pre-bankruptcy contractual bargains—a guarantee Congress explicitly gave only to home mortgage lenders. Moreover, if *all* secured lenders received their contract rate, homeowners would have appreciably less available to pay the mortgage. The inevitable result: more foreclosures.

Significantly for AARP members, the Bankruptcy Code's home mortgage exception does *not* apply to mobile homes. The courts generally treat mobile homes as personal property (not realty) and, as such, mobile home lenders and borrowers are not bound to the contract rate of interest in cramdowns.[8] This heightens the impact of the decision in this case on mobile homeowners and, accordingly, on older Americans. In 2001, 2.5 million people age 50 and older owned mobile homes. These older homeowners occupied almost half of the nation's stock of owner-occupied manufactured housing. *See* AARP, *Issues in Manufactured Housing*, *at* http://research.aarp.org/il/fs16r_housing.html (May 2001).

Older Americans are particularly vulnerable to predatory lending in the manufactured housing market, where a high proportion of buyers have low incomes and fewer choices. *Id.* The median annual income for older Americans (50 and

[8] *See In re Enewally*, 276 B.R. 643, 646 n.4 (Bankr. C.D. Cal. 2002) ("[S]tatutory exception [§ 1322(b)(2)] does not apply to a debtor's principal residence if that residence is a mobile home."); *Homeowners Funding Co. v. Skinner*, 129 B.R. 60, 64 n.2 (E.D.N.C. 1991) ("[M]obile home is personal property, not real property, and therefore the prohibition against modification" does not apply.).

over) who own manufactured housing was $20,000. By contrast, it was $34,000 for older Americans (50 and older) who own conventional single-family housing. *Id.*

Older Americans constitute an ever growing and disproportionately large share of mobile homeowners. The *Till* decision will have a particularly widespread impact on their future. A mobile home is no less a home. The "presumptive" application of higher contract interest rates will mean fewer confirmed and completed Chapter 13 plans and fewer older Americans who can save those homes.

Contract Rate by Law: Other Examples

In a series of other provisions, Congress explicitly has permitted creditors to collect, in bankruptcy, either a market-based or contract rate of interest. In general, the Code limits a creditor's ability to avoid the automatic stay and proceed against property subject to a security interest. *See* 11 U.S.C. § 362(d). For one kind of creditor, however, secured by "single asset real estate," 11 U.S.C. § 101(51B), Congress has guaranteed a specific rate of interest.[9] To keep the property, the debtor must make monthly interest payments "at a current fair market rate on the value of the creditor's interest in the real estate." 11 U.S.C. § 362(d)(3).

The Bankruptcy Code also preserves the contractual rights of oversecured creditors: "[t]o the extent that an allowed secured claim is secured by property the value of which ... is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and *any reasonable fees, costs, or charges provided for under the agreement under which such claim arose*." 11 U.S.C. § 506(b) (emphasis added); *see also United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989).

[9] Congress created several specific procedures for business bankruptcy cases that involve only one piece of real property—a single apartment building, for example—in response to reported abuses by debtors. *See generally* 11 U.S.C. § 362(d)(3).

In settling the rights of unsecured creditors, as well as secured creditors, Congress has made another deliberate decision to recognize market forces. The reaffirmation provision, section 524(c), enables a debtor to retain property through bankruptcy. In effect, it allows a debtor to "reaffirm" a debt voluntarily, entering into a new agreement with a creditor, even though the debt is dischargeable and the debtor has no obligation, post-bankruptcy, to pay. Section 524 permits a debtor to pay any creditor *any* negotiated rate of interest—typically, in exchange for retaining purchased goods or obtaining new credit. The parties themselves determine the interest rate.

Finally, another fundamental principle of the Bankruptcy Code—the debtor's ability to assume or reject executory contracts—demonstrates that Congress can and does mandate strict adherence to pre-petition contract terms in specific circumstances. Under 11 U.S.C. § 365(b), the debtor can assume a contract or lease but only if the debtor cures "any actual pecuniary loss" from any default in the contract's terms. The debtor must honor all of the contract's terms to benefit from it post-bankruptcy.

In summary, the Code generally permits debtors, whether conglomerates in Chapter 11 or families in Chapter 13, to modify contractual terms in a court-approved plan. The exceptions to that general rule are necessarily explicit. With the sole exception of home mortgage rates, Congress has avoided guaranteeing any creditor the benefit of the contract rate of interest. All that is guaranteed is the collateral's "value, as of the effective date of the plan" for secured creditors receiving installment payments in Chapter 13.

D. By Providing Specific Rates Of Interest In Other Sections Of The Code, Congress Necessarily Excluded Contract Rates From Section 1325.

"Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally

and purposely in the disparate inclusion or exclusion." *Russello*, 464 U.S. at 23 (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972)). Congress expressly provided for a contract or market rate of interest in several Code sections, *e.g.*, 11 U.S.C. §§ 1322(b)(2), 324(d)(3), and provided for contractual fees and costs in another, § 506(b). But Congress provided no such guarantee for cramdowns. Indeed, by definition, a cramdown involves the modification of creditors' rights, whether the loan was for a car, a mobile home, or any other property—except, of course, a home mortgage. *See Am. Gen. Fin., Inc. v. Paschen (In re Paschen)*, 296 F.3d 1203, 1206 (11th Cir.), *cert. denied*, 123 S. Ct. 696 (2002); *Key Bank N.A. v. Milham (In re Milham)*, 141 F.3d 420, 425 (2d Cir. 1998).

This Court has used a similar comparative analysis to interpret other sections of the Bankruptcy Code. In *Timbers*, the issue was "whether undersecured creditors are entitled to compensation ... for the delay caused by the automatic stay in foreclosing on their collateral." 484 U.S. at 369. In response, this Court had to reconcile section 362 with another Code provision, section 506(b): "[t]o the extent that an allowed secured claim is secured by property the value of which ... is greater than the amount of such claim, there shall be allowed ... interest on such claim ...."

The Court held that the undersecured creditor could not collect post-petition interest during the bankruptcy:

> If the Code had meant to give the undersecured creditor, who is thus denied interest on his [entire] *claim*, interest on the value of his *collateral*, surely this is where that disposition would have been set forth, and not obscured within the "adequate protection" provision of § 362(d)(1). Instead ..., § 506(b) would simply have said that the secured creditor is entitled to interest "on his allowed

> claim, or on the value of the property securing his allowed claim, whichever is lesser."

Timbers, 484 U.S. at 372-73. Had Congress intended undersecured creditors to receive interest on the value of their collateral, the statute would have so stated.

The cramdown statute can be evaluated, similarly, only in the context of the entire Bankruptcy Code. *See id.* at 371. The absence of any language requiring a contract or variable rate of interest in section 1325—and the complementary presence of precisely that language for home mortgage lenders in that section and for others elsewhere in the Code—unequivocally reflects legislative intent. Congress did not intend to apply a contract rate of interest in Chapter 13 cramdowns.

II. SECTION 1325 PERMITS SECURED CREDITORS ONLY THE TIME VALUE OF MONEY, EXPRESSED IN THE TREASURY BILL RATE.

Congress understands that a dollar tomorrow is worth less than a dollar today, so it added that factor to the Chapter 13 repayment plan. *See* H.R. REP. NO. 95-595, at 413 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6369 (the identical cramdown provision in Chapter 11 is intended to recognize the "time-value of money"). By choosing "value, as of the effective date of the plan" as the quantitative measure, Congress compensated secured creditors for the delay in receiving the value of the collateral at confirmation, but it offered nothing more.

> Confirmation of any [Chapter 13] plan requires that the plan proponent compensate a secured creditor for any delay in receiving the payment of the value of its collateral. The courts agree that the Code requires a *time-value of money analysis* comparing the interest rate offered with the proposed deferred payments to the creditor at a minimum rate found by the court to fairly and equitably compensate the creditor for the delay.

Hon. John K. Pearson et al., *Ending the Judicial Snipe Hunt: The Search for the Cramdown Interest Rate*, 4 AM. BANKR. INST. L. REV. 35, 36-37 (1996) (emphasis added).

A secured creditor that receives more than the time value of money receives not "value, as of the effective date of the plan" but, instead, compensation for risk, reimbursement of overhead, profits or another premium. Those elements are not included either in the framework for Chapter 13 or in the explicit statutory language of section 1325—except, of course, for home mortgage lenders.

A. The Time Value Of Money, Expressed In The Treasury Bill Rate, Is The Only Measure Consistent With Section 1325's Plain Language.

The contract rate presumptively imposed by the Seventh Circuit, advancing the "coerced loan" theory, has no basis in the Bankruptcy Code, its context or its purpose. What, then, is the statutory basis for determining "value" over time?

Three circuits—the Second, Eighth and the Ninth—have adopted a formula to determine the appropriate rate of interest in cramdowns. *See supra* at 6. This approach generally uses a standard rate objectively determined and, then, adds a risk premium, usually between one and three percent, to arrive at an appropriate cramdown interest rate.

The premium formula is preferable to the coerced loan method because it provides consistent treatment for all secured creditors without a windfall for subprime lenders. Yet it, too, lacks a statutory basis. While the formula is more objective, more predictable and easier to apply than the coerced loan presumption, there is a more objective and predictable standard that expresses the mandate of Congress.

The Treasury bill rate is the most commonly used standard to compensate for the time value of money.[10] *See,*

[10] "Bonds issued by the U.S. Treasury Department have different names depending on their term to maturity. Treasury bills are short-term

e.g., *Standard Mfg. Co., Inc. v. United States*, 42 Fed. Cl. 748, 778 (1999) (most appropriate rate for calculating damages for the delay in receiving past due royalties because it "account[s] for inflation while avoiding a reward for risks which the plaintiff did not undertake"); *MHC, Inc. v. Oregon Dep't of Revenue*, 66 F.3d 1082, 1090 (9th Cir. 1995) (proper way to calculate interest on unpaid taxes because it places "the prevailing party in the same position in which it would have been had it not been deprived of the sum owed it but instead had benefitted from the full use of the money during the period of deprivation.").[11] Establishing the time value of money through the Treasury bill rate is easily ascertainable and predictable. Courts, accountants, parties negotiating contracts and financial markets use the rates for literally millions of transactions daily to determine what a dollar today is expected to be worth any time in the future.

B. Congress Used Precisely The Same Language At Issue Here To Describe The Collective Rights Of Unsecured Creditors In Chapter 13.

The Treasury bill rate maintains equal treatment among secured creditors. Of no less importance, it ensures the consistent treatment of all creditors mandated by Congress.

In describing the amount that the plan must provide secured creditors, section 1325 requires that they retain their lien and that: "the value, as of the effective date of the plan,

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obligations, with maturity of up to 1 year...." JEFFREY D. SACHS AND FELIPE LARRAIN, MACROECONOMICS IN THE GLOBAL ECONOMY 621 (1st ed. 1993).

[11] Congress also directed the use of the Treasury bill rate to calculate the time value of money in all civil and criminal cases. Federal law sets the post-judgment interest rate in civil cases: "Such interest shall be calculated from the date of the entry of the judgment, at a rate equal to the weekly average 1-year constant maturity Treasury yield ... for the calendar week preceding the date of the judgment." 28 U.S.C. § 1961(a); *see* 11 U.S.C. § 726(a)(5). Similarly, interest on unpaid criminal fines or restitution is computed "at a rate equal to the weekly average 1-year constant maturity Treasury yield ...." 18 U.S.C. § 3612(f)(2)(B).

of property to be distributed under the plan on account of such [secured] claim is not less than the allowed amount of such claim." In the immediately preceding section, however, Congress used identical language to describe the required payments to *unsecured* creditors. The plan must ensure that:

> [T]he value, as of the effective date of the plan, of property to be distributed ... on account of each allowed unsecured claim is not less than the amount that would be paid ... if the estate of the debtor were liquidated under chapter 7 ... on such date.

11 U.S.C. § 1325(a)(4). In other words, for unsecured creditors, the plan must provide at least the present value of what they would have received in liquidation.

Both secured and unsecured creditors rely on precisely the same language—"value, as of the effective date of the plan"—to determine the amount to be paid on their claims. In the avalanche of litigation over the amounts payable in Chapter 13, however, no one has ever made the audacious argument that unsecured creditors collectively should receive a premium to reflect the "risk" that the debtor will not be able to repay as promised, a "profit," or the "overhead" that the creditors have borne. No one contends that "value, as of the effective date of the plan" entitles different unsecured creditors to different present value calculations based on the contract rates of interest they once charged or the interest rate they could charge if they lent that money today.

An unsecured subprime credit card lender and a physician (who charges no interest and has no lien) are entitled to the same treatment of their claims, the "value" of what they would have received in liquidation. "Surely, Congress did not intend that each unsecured creditor would receive a market rate or its contract rate of interest ... with different unsecured creditors receiving different rates, depending on the type of loan." 8 COLLIER ON BANKRUPTCY ¶ 1325.06[3][b], at 1325-36 (Alan N. Resnick & Henry J.

Sommer eds., 15th ed. rev. 2003). Unsecured creditors share a uniform basis for determining "value, as of the effective date of the plan"—regardless of their individual contract rates. So should secured creditors.

According to the appellee, "value, as of the effective date of the plan" has two different meanings—one in section 1325(a)(4) and a wholly different meaning a few lines later in the Code in section 1325(a)(5). Congress could have provided a different formulation for the two groups of creditors, but it did not. It is not for the courts to insist on differential repayments among creditors within a single class (secured or unsecured), nor to insist that different classes of creditors be treated differently when the Congressional framework does not call for it.

III. THE SEVENTH CIRCUIT UPSET THE CAREFUL BALANCE AMONG CREDITORS ESTABLISHED BY CONGRESS IN CHAPTER 13.

Chapter 13 creates a defined, finite pool for repayment. To confirm a plan, the Bankruptcy Code requires that *all* debtors pay *all* of their "disposable income" to a trustee for distribution to their creditors. By definition, if one creditor takes more, either the plan will not be confirmed or less will remain for all of the others. Congress deliberately balanced the competing rights of creditors as well as the creditors' collective rights against those of the debtor. A court-imposed contract-based rate of return that varies from secured creditor to secured creditor (and is unavailable to unsecured creditors) would destroy that balance.

A. Chapter 13 Is A Fixed-Payment System.

Both Chapter 11 and Chapter 13 use a debtor's post-petition income to pay pre-petition debt through a plan of reorganization. The principles are the same, whether for a retired couple or for a multinational conglomerate: repayments over time generally yield greater returns for creditors collectively, and a reorganized debtor is a stronger economic competitor.

In both Chapter 11 and Chapter 13, certain creditors are entitled to certain minimum payments (a plan must propose to pay taxes in full, for example, and to pay creditors at least the present value of what they would have received in liquidation). *See* 11 U.S.C. §§ 1129, 1325. In Chapter 11, while an individual creditor always can object, the total a debtor must repay ultimately will be subject to a vote of the creditors. *See* 11 U.S.C. §§ 1102, 1103. Not surprisingly, Chapter 11 debtors negotiate with their creditors to achieve a consensual plan to provide for payments that, all parties agree, are both reasonable and sustainable.

By contrast, Chapter 13 has no negotiate-and-vote structure. Families with more than $1.15 million in secured and unsecured obligations are barred from Chapter 13. So are corporations. *See* 11 U.S.C. § 109(e). To create a workable system for financially-troubled consumers and to assure pro-rata protection even for creditors with small claims, Congress designed Chapter 13 with low transaction costs. Creditors have no right to vote on the reorganization plan, eliminating much of the need for negotiation. Instead, Congress mandates the repayment structure for each class of creditors, and a trustee administers it.

Under the 1978 Code as enacted, Chapter 13 debtors unilaterally set the repayment amount. *See* 11 U.S.C. §§ 1322, 1325 (1978). Once they met certain minimum payments, the debtors needed only to convince a bankruptcy judge that their proposed payments were "in good faith." 11 U.S.C. § 1325(a) (1978). In 1984, however, Congress changed that. It required that Chapter 13 debtors commit *all* of their "disposable income" to their repayment plans. 11 U.S.C. §§ 1322(a)(1), 1325(b). (For the Tills, that is $740.00 a month.)

Now, a debtor can confirm a plan of reorganization only if (among other constraints) the debtor agrees: first, to pay secured creditors the value of their collateral; second, to pay unsecured creditors at least the value they would have

received in liquidation; and, third, to commit all disposable income for three to five years to the repayment plan. *See* 11 U.S.C. § 1325. With this change, the focus in Chapter 13 shifted to the competing rights of creditors.

Any decision that permits one creditor to increase its own payments means that other creditors lose payments. In addition, every increase in the amount any one creditor can demand as a condition of confirmation—the interest rate a mobile home lender receives for cramdown confirmation, for example—will deny some debtors any relief in Chapter 13, often resulting in the loss of the home. Every plan must simultaneously satisfy the amount guaranteed by statute for each class of creditor *and* provide a minimum amount of disposable income for general distribution. Accordingly, as the first amount increases, it inevitably exhausts the disposable income pool in a growing number of cases. When that happens, the debtor cannot confirm a plan. The debtor then must either liquidate under Chapter 7 or flee the bankruptcy system altogether, leaving creditors with little or no repayment or with a free-for-all collection stampede under non-bankruptcy law.

This Court's decision will apply to all secured debt in Chapter 13—car loans, mobile home loans, loans secured by retirement plans, and credit card debts secured by the consumer items purchased. The same "value" language appears in Chapter 11 and Chapter 12 as well as in Chapter 13. As a result, the implications of this case resonate universally in the Bankruptcy Code. The Seventh Circuit's decision endorsing unbalanced interest rates threatens the balance of the entire bankruptcy system.

B. A Contract-Based Present Value Rule Would Frustrate Congress's Well-Established Policies.

Bankruptcy law has long embraced the fundamental premise that, in distribution, "equality is equity." *United States Rubber Co. v. American Oak Leather Co.*, 181 U.S. 434, 452 (1901). Permitting some creditors to demand their

pre-petition contract rate of interest frustrates the universally recognized principle that creditors holding legally similar rights, secured or unsecured, should receive equal treatment within their class. *See Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 543 (1946) (bankruptcy plans must be "fair and equitable" and not "discriminate unfairly" against any creditors).

Each general unsecured creditor receives the same proportional distribution from the estate, regardless of the interest rates "established" in their pre-bankruptcy consumer contracts. This principle is no less compelling for the treatment of interest for secured creditors. Any two secured creditors suffer the same deprivation of their rights in bankruptcy. They are limited by law to the same calculation of their allowed secured claims. *See* 11 U.S.C. § 506(b). They face the same risk from the debtor's failure to make plan payments, and they each feel the potential impact of the lost time value of money. At the same time, all secured creditors enjoy the same protection in the bankruptcy system—court and trustee supervision of the debtor, for example, and trustee administered payments.

A uniform interest rate for the time value of money, on each allowed secured claim, guarantees equality among the secured creditors in addition to protecting debtors. If, however, each secured creditor is entitled to demand—as a matter of law—the interest payment in its original loan, equality disappears.

> These creditor-based approaches to interest rates ... in Chapter 13 cases are nightmares of logic and application. Nothing in § 1325(a)(5)(B)(ii) suggests that "value, as of the effective date of the plan" is a creditor-specific concept. If present value varies from creditor to creditor depending on facts specific to each creditor's financial condition, management and lending practices, then the

> interest rate at confirmation in a Chapter 13 case will be different with respect to every claim .... It is not imaginable that Congress intended "value, as of the effective date of the plan" to mean that inefficient, poorly managed lenders get higher interest rates than well managed, better capitalized lenders.

2 LUNDIN, CHAPTER 13 BANKRUPTCY § 112.1, at 112-9.

Three cases illustrate the principle: a car dealer who sells an average used car (sale price: $13,493) with the average car loan interest rate (5.6 percent), a car dealer who sells the same used car at the Tills' subprime rate (21 percent), and a car dealer who sells the car for zero percent or nominal interest, adding $3,000 to the sales price to compensate for the time value of the money.[12] If the debtor filed for bankruptcy having just purchased all three cars, all three creditors would be entitled to the present value of the replacement cost of the car: $13,493 (under the opinion in *Rash*) regardless of the actual purchase price or the loan amount due. If the cramdown interest rate were uniform, all three would enjoy the same protection in Chapter 13, taking the same risks and receiving the same payments.

Yet if the interest payments depend on each creditor's contract rate, dramatic differences appear. If the debtor financed the car purchase over five years, the subprime lender would receive $365 each month in a reorganization plan. The average-rate lender would be entitled to monthly payments of $258. The zero-interest lender would receive $225. Over the five year life of the plan, those differences would increase exponentially.

[12] National Auto Dealers Ass'n, *Average Dealership Profile, May 2003, at* http://www.nada.org/content/NavigationMenu/MediaCenter/NADAData/20033/May2003.pdf (July 2003); Bankrate.com, *Rates, calculators, indepth articles and professional advice, at* http://bankrate.com/brm/rate/auto_home.asp (accessed on Aug. 11, 2003).

- At zero-interest, the dealer would receive total payments of $13,493 (the car's actual value)
- At the average rate, the dealer would receive $15,480
- At the subprime rate, the dealer would receive $21,900

The careful balance Congress established—treating all secured creditors equally, giving all the same rights to collect the present value of their collateral and denying all of them the right to repossess the collateral and resell it—would evaporate. Instead, the pre-bankruptcy "bargains," not the Bankruptcy Code, would govern the distribution of the debtor's assets. Only the time value of money compensates all of the creditors equally and fairly.

Every dollar paid to a secured creditor is a dollar not paid to an unsecured creditor. In the example above, the $8,400 difference between the payments at "zero interest" and those at the subprime rate would be available to be divided equitably among all of the creditors. The application of the Treasury bill rate would compensate the secured creditor for the delay in receiving the collateral's value but still leave $8,040, over the life of the plan, for unsecured creditors. Apply the subprime rate, however, and all of the difference goes to one creditor. A decision to affirm the Seventh Circuit would literally eliminate millions of dollars annually in recoveries for unsecured creditors. The loss would fall particularly hard on health care providers and other unsecured creditors that have little opportunity to charge any interest and on the older Americans who rely disproportionately on them.

Today, debtors pay an estimated $3 billion to creditors through the Chapter 13 system. Ed Flynn et al., *Bankruptcy by the Numbers—A Tale of Two Chapters: Financial Data*, 21 ABI J. No. 8 (Oct. 2002), *available at*, http://www.usdoj.gov/ust/press/articles/abilo2002.htm. Every debtor denied access to Chapter 13 by the Seventh Circuit's "coerced loan" approach to interest rate calculations is a debtor, typically an

older American, who does not pay his or her health care provider or insurer or loses the family home. Every creditor, other than a subprime lender, loses twice—once in the distributional system for debtors who still can confirm and complete a Chapter 13 plan and once in the harsh consequences, including no payment at all, for debtors who can neither confirm nor complete a plan.

The effect on a debtor of a secured creditor's demand for interest at the contract rate is less obvious, but no less important. To continue the example, for the debtor who has $300 a month in disposable income, the difference between a Treasury bill rate for the time value of money ($230) and a subprime rate ($365) is literally the difference between confirming a plan and saving a home in Chapter 13 and liquidating in Chapter 7. The test for confirmation—that the debtor commit all disposable income *and* that secured creditors receive the value of their allowed secured claims—means that some plans simply cannot be confirmed if a subprime interest rate applies through Chapter 13.

Any denial of access to Chapter 13 falls hardest on homeowners, particularly on older Americans who are more likely to own their own home.[13] While they cannot rewrite their contracts with their mortgage lenders, Chapter 13 offers them a unique opportunity to de-accelerate a mortgage in default and catch up on their payments. Growing up during the Depression, many struggled to purchase and maintain their home. Now, those homes are their principal asset. Without access to Chapter 13, more Americans will find it harder to keep their homes, and more older Americans will face a bleak future.

Congress consistently has reaffirmed the principle that whether the debtor uses Chapter 7 or Chapter 13, "bankruptcy relief should be effective, and should provide the debtor with a fresh start." H.R. REP. NO. 95-595, at 118, 129 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6078-79. Beyond that, Congress has expressed a clear preference for chapter 13 proceedings (the "use of the [consumer] bankruptcy law should be a last resort" and "if it is used, debtors should attempt repayment under Chapter 13...."). *Id.* at 117.

[13] More than 30 million Americans over the age of 55 own their principal residence. *The Policy Book: AARP Public Policies 2003* at 9-1.

The flexibility permitted in Chapter 13 is "central to the implementation of the congressional goal" of encouraging its use. 8 COLLIER ON BANKRUPTCY ¶ 1322.01, at 1322-5. An indispensable component of that flexibility is the ability to bring all secured creditors—those charging 21 percent interest and those charging no interest—into alignment, not to cripple a Chapter 13 plan before it begins by permitting one creditor to demand an extraordinary rate of interest.

C. The Use Of The Treasury Bill Rate, To Measure The Time Value Of Money, Will Ensure That No Creditors Will Be Overcompensated.

This Court already has established the principle that secured creditors in bankruptcy are not permitted to collect for benefits they have not conferred on the debtor:

> Our recognition that the replacement-value standard, not the foreclosure-value standard, governs in cram down cases leaves to bankruptcy courts, as triers of fact, identification of the best way of ascertaining replacement value .... *[R]eplacement value, in this context, should not include certain items. For example, where the proper measure of the replacement value of a vehicle is its retail value, an adjustment to that value may be necessary:* ***A creditor should not receive portions of the retail price, if any, that reflect the value of items the debtor does not receive when he retains his vehicle,*** *items such as warranties, inventory storage, and reconditioning.*

Rash, 520 U.S. at 965 n.6 (emphasis added). Determining the value of collateral retained by the debtor in a Chapter 13 cramdown, this Court emphasized that creditors should not receive any compensation unless the Bankruptcy Code explicitly entitles them to it.

A judicially-imposed "contract rate" in bankruptcy is neither a practical nor a meaningful concept. The "coerced loan" theory's fundamental assumption that cramdown actually forces a new loan upon the unsuspecting subprime creditor overlooks the vital point that ordinary market forces are no longer at work in Chapter 13. These are not new loans at all—coerced or otherwise—just claims in bankruptcy.

The Bankruptcy Code imposes repayment requirements precisely because the each-creditor-for-itself approach of the market has been replaced by the collective action of bankruptcy. The debtor's post-filing earnings, along with all of the debtor's other assets, become property of the estate and their disposition subject to supervision by the court. The law relieves creditors of the burdens associated with making loans, such as hiring legal counsel or collection agents to assert their rights. A court-appointed trustee monitors the debtor for them, ensuring that the debtor has committed all disposable income to repayment under the plan. The trustee supervises payments as well and brings the debtor to court if payments are not timely made.

The trustee has the power to order funds deducted from a debtor's paycheck if he or she fails to make payments, even in states where wage deduction is otherwise unavailable. *See* 11 U.S.C. § 1325(c). If the debtor's income rises, the repayment to creditors also rises under 11 U.S.C. § 1329. The debtor is prohibited from purchasing any goods and services beyond those the court deems reasonably necessary for daily life. Chapter 13 "aggressively direct[s] the finances of the debtor"—all at no cost to the individual creditor. Roger Whelan et al., *Consumer Bankruptcy Reform: Balancing the Equities in Chapter 13*, 2 AM. BANKR. INST. L. REV. 165, 185 (1994).

By contrast, if there were a post-petition "market," as the coerced loan theory presumes, lenders would have to bear all the costs of supervision. They would not benefit from the extraordinary powers granted the court and the trustee in Chapter 13. Accordingly, any contract rate overcompensates creditors for administrative and collection costs that are either reduced or eliminated. "Indeed, in no reported case has a court concluded, based on evidence presented, that any actual market exists in which a lender makes loans to debtors under the circumstances which generally prevail in reorganization." David G. Epstein, *Don't Go and Do Something Rash About Cram Down Interest Rates*, 49 ALA. L. REV. 435, 464 (1998).

Bankruptcy was not designed to guarantee creditors' profits, which differ widely from creditor to creditor based on risk, market conditions and business judgment. In rejecting the coerced loan approach later used in the Seventh Circuit, the Second Circuit emphasized just that:

> The objective of § 1325(a)(5)(B)(ii) is to put the creditor in the same economic position that it would have been in had it received the value of its allowed claim immediately.... There is no reason, therefore, that the interest rate should account for profit.... Otherwise, the creditor will receive more than the present value of its allowed claim.

In re Valenti, 105 F.3d at 63-64. The determination of value, as of the effective date of the plan, "should not be controlled by a rate negotiated pre-petition between the parties. Such pre-petition rates include the lender's profits and costs[,] but all that is required under section 1325(a)(5)(B) is that [the secured creditor] receive the present value of its claim adjusted for inflation and delay in payment." *In re Marquez*, 270 B.R. 761, 770 (Bankr. D. Ariz. 2001). To ensure that the

secured creditor receives that value, this Court should apply the Treasury bill rate—nothing more, nothing less.

CONCLUSION

The economic vulnerability of older Americans will grow even more severe as the next generation reaches retirement age. *See* TERESA A. SULLIVAN, ELIZABETH WARREN AND JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 38-41, 164-66 (2000). They are entitled to the protection Congress gave them in the Bankruptcy Code. Creditors have the Code's protection as well. The statutory balance established by Congress, however, does not entitle subprime lenders to demand greater returns at the expense of every other creditor.

Congress designed Chapter 13 to ensure that families have both a fresh start and the opportunity to repay at least some of their debts, retaining at least some of their property including the family's home. AARP joins the Tills in asking this Court to reverse the decision of the U.S. Court of Appeals for the Seventh Circuit. Some creditors should not be permitted to charge a "contract" rate of interest that will both overcompensate them and undermine the effectiveness and balance of the bankruptcy system itself.

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Dated: August 28, 2003.

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